



**REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS
AUDIT EXAMINATION OF THE
FINANCIAL STATEMENTS OF THE
TRANSPORTATION CABINET**

Fiscal Year Ended June 30, 2001

**Performed by
Potter & Company, LLP**

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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Paul E. Patton, Governor
James C. Codell, III, Secretary
Transportation Cabinet

The enclosed report prepared by Potter & Company, LLP, Certified Public Accountants, presents the financial statements of the Transportation Cabinet for the fiscal year ended June 30, 2001.

We engaged Potter & Company, LLP, to perform the financial audit of this agency. We worked closely with the firm during our report review process; Potter & Company, LLP, evaluated the Transportation Cabinet's internal controls and compliance with applicable laws and regulations.

Respectfully submitted,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

Enclosure

**TRANSPORTATION CABINET
OF THE COMMONWEALTH
OF KENTUCKY**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

June 30, 2001

**TRANSPORTATION CABINET OF THE
COMMONWEALTH OF KENTUCKY
FRANKFORT, KENTUCKY**

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INDEPENDENT AUDITOR'S REPORT

Mr. James C. Codell, III, Secretary
Transportation Cabinet of the
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Commonwealth of Kentucky

We have audited the accompanying general-purpose financial statements of the Transportation Cabinet of the Commonwealth of Kentucky, as of and for the year ended June 30, 2001, as listed in the table of contents. These general-purpose financial statements are the responsibility of the Cabinet's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, as issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Transportation Cabinet of the Commonwealth of Kentucky, and are not intended to present fairly the financial position of the Commonwealth of Kentucky, or the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the general-purpose financial statements referred to above present fairly, in all material respects, the financial position of the Transportation Cabinet of the Commonwealth of Kentucky as of June 30, 2001, and the results of its operations and cash flows of its proprietary fund types for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 26, 2001, on our consideration of the Transportation Cabinet of the Commonwealth of Kentucky's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Mr. James C. Codell, III, Secretary
Transportation Cabinet
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Commonwealth of Kentucky

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Our audit was made for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The combining and individual fund financial statements on pages 29 through 31 are presented for purposes of additional analysis and are not a required part of the general-purpose financial statements of the Cabinet. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements and, in our opinion, is fairly presented in all material respects in relation to the general-purpose financial statements taken as a whole.

A handwritten signature in black ink that reads "Potter & Company, LLP". The script is cursive and fluid, with the letters "P" and "C" being particularly large and stylized.

POTTER & COMPANY, LLP
November 26, 2001

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
ALL FUND TYPES AND ACCOUNT GROUPS
COMBINED BALANCE SHEET
June 30, 2001

ASSETS

	<u>Governmental Fund Type</u>		<u>Proprietary Fund Type</u>		<u>Fiduciary Fund Type</u>		<u>Account Group</u>		<u>Total (Memorandum Only)</u>
	<u>Special Revenue Fund</u>	<u>Capital Projects</u>	<u>Internal Service Fund</u>		<u>Agency Fund</u>		<u>General Fixed Assets</u>	<u>General Long-Term Debt</u>	
Cash on hand, in banks, and on deposit with State Treasurer	\$ 83,725,186	\$ 4,001,361	\$ 479,781	\$ 5,096,411	\$				\$ 93,302,739
Investments	617,946,091	23,332,607	2,539,000	26,669,000					670,486,698
Inventory of supplies	26,425,282								26,425,282
Taxes receivable, principally motor vehicle fuel and excise	58,939,255								58,939,255
Intergovernmental receivables, principally federal revenue	100,093,555	300,000	3,133						100,396,688
Interfund receivables - state agencies	21,296,570								21,296,570
Restricted assets	2,117,114								2,117,114
Fixed assets			30,179,738				213,474,023		243,653,761
Amount to be provided for:									
Retirement of compensated absences								37,100,245	37,100,245
Retirement of long-term debt								12,918,220	12,918,220
Claims and judgements								24,430,000	24,430,000
Total assets	\$ 910,543,053	\$ 27,633,968	\$ 33,201,652	\$ 31,765,411	\$ 213,474,023	\$ 74,448,465	\$ 1,291,066,572		

LIABILITIES

Accounts payable and accrued liabilities	\$ 84,146,773	\$ 239,891	\$ 103,578	\$ 31,765,411	\$				\$ 116,255,653
Claims liability, current			2,905,469						2,905,469
Leases payable, current			1,186,768					3,022,355	4,209,123
Accrued compensated absences								37,100,245	37,100,245
Claims and judgements	9,000,000							24,430,000	33,430,000
Deferred revenue	147,575,128								147,575,128
Claims liability, long-term			16,944,320					9,895,865	16,944,320
Leases payable, long-term			2,685,232						12,581,097
Total liabilities	240,721,901	239,891	23,825,367	31,765,411	0	74,448,465	371,001,035		

FUND BALANCE				
Investment in fixed assets				
Reserve for encumbrances	214,709,378		213,474,023	213,474,023
Reserve for inventory supplies	26,425,282			214,709,378
Reserve for restricted assets	2,117,114			26,425,282
Reserve for statutory obligations	57,078,000			2,117,114
Reserve for capital outlay		27,394,077		57,078,000
Unreserved:				27,394,077
Designated for subsequent year's expenditures	300,449,495			
Undesignated	69,041,883			
Retained earnings, unreserved		29,226,074		300,449,495
Accumulated deficit		(19,849,789)		69,041,883
				29,226,074
				(19,849,789)
Total fund balance	669,821,152	27,394,077	213,474,023	920,065,537
Total liabilities and fund balance	\$ 910,543,053	\$ 27,633,968	\$ 213,474,023	\$ 1,291,066,572

See accompanying notes.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
GOVERNMENTAL FUND TYPE
 COMBINED STATEMENT OF REVENUES, EXPENDITURES
 AND CHANGES IN FUND BALANCES
 For the Year Ended June 30, 2001

	Governmental Fund Type	
	Special Revenue Fund	Capital Projects Fund
Revenues:		
Taxes	\$ 951,844,053	\$
License, fees, and permits	107,169,291	
Charge for services	21,211,119	
Fines and forfeits	9,611	
Interest and other investment income	58,306,530	75,461
Other revenues	50,131,127	
Total	1,188,671,731	75,461
Intergovernmental revenues:		
Federal government	465,508,861	
Turnpike Authority of Kentucky	61,399,380	
Other governmental units	50,762,508	
Total revenues	1,766,342,480	75,461
Expenditures:		
General administrative and support	60,153,533	
Air transportation	3,972,949	
Revenue sharing	214,871,152	
Rail transportation	33,686	
Public transportation	57,809,249	
Highways	1,200,702,565	
Vehicle regulation	34,600,872	
Governors Office for Technology	90,868	
Economic Development Bond Projects	63,868,616	
Justice Cabinet	30,000,000	
Revenue Cabinet	1,385,000	
Finance and Administration Cabinet	276,840	
Capital projects		14,267,071
Total expenditures	1,667,765,330	14,267,071
Excess (deficiency) of revenues over expenditures	98,577,150	(14,191,610)
Other sources (uses) of financial resources:		
Operating transfers in (out):		
General Fund	6,137,185	
Capital Projects	(10,370,000)	22,370,000
Finance and Administration Cabinet	(3,665,000)	
Debt service / lease rental payments	(150,649,800)	
Other transfers-net	1,727,599	
Net other sources (uses) of financial resources	\$ (156,820,016)	\$ 22,370,000

See accompanying notes.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
GOVERNMENTAL FUND TYPE

COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES (CONTINUED)

For the Year Ended June 30, 2001

	Governmental Fund Type	
	Special Revenue Fund	Capital Projects Fund
Excess (Deficiency) of revenues over expenditures and net other sources (uses) of financial resources	\$ (58,242,866)	\$ 8,178,390
Fund balance, July 1, 2000	728,122,132	19,215,687
Increase in reserve for restricted assets	911,423	
Decrease in reserve for supplies	(969,537)	
Fund balance, June 30, 2001	\$ <u>669,821,152</u>	\$ <u>27,394,077</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
INTERNAL SERVICE FUNDS
STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN RETAINED EARNINGS (ACCUMULATED DEFICIT)
For the Year Ended June 30, 2001

Operating revenues:	
Contributions received	\$ 3,611,366
Charges for sales and services	<u>22,745,079</u>
Total operating revenues	<u>26,356,445</u>
Operating expenses:	
Workers' compensation claims expense	3,680,127
Legal expense	220,077
Administrative expense	69,844
Costs of sales and services	13,880,519
Depreciation	<u>12,016,743</u>
Total operating expenses	<u>29,867,310</u>
Operating loss	(3,510,865)
Other income (expense):	
Interest expense, net	(307,520)
Interest and other investment income	4,350
Gain on sale of equipment	<u>121,772</u>
Total other income (expense)	<u>(181,398)</u>
Net loss	\$ <u><u>(3,692,263)</u></u>
Retained earnings, July 1, 2000	\$ 32,559,655
Net loss allocable to retained earnings	<u>(3,333,581)</u>
Retained earnings, June 30, 2001	\$ <u><u>29,226,074</u></u>
Accumulated deficit, July 1, 2000	\$ (19,491,107)
Net loss allocable to accumulated deficit	<u>(358,682)</u>
Accumulated deficit, June 30, 2001	\$ <u><u>(19,849,789)</u></u>

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TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL (BUDGETARY BASIS)
For the Year Ended June 30, 2001

	Governmental Fund Types				
	Special Revenue		Capital Projects		Favorable (Unfavorable)
	Budget	Actual	Favorable (Unfavorable)	Budget	Actual
Revenues:					
Taxes	\$ 908,899,103	\$ 903,322,482	\$ (5,576,621)	\$ 0	\$ 0
License, fees and permits	113,227,369	108,795,208	(4,432,161)	0	0
Charges for services	19,895,000	21,211,119	1,316,119	0	0
Fines and forfeits	25,000	9,611	(15,389)	0	0
Interest and other investment income	29,500,000	40,187,239	10,687,239	0	0
Other revenues	40,989,784	45,125,837	4,136,053	0	0
Total	1,112,536,256	1,118,651,496	6,115,240	0	0
Intergovernment revenues:					
Federal Government	500,147,600	498,401,236	(1,746,364)	0	0
Turnpike Authority of Kentucky	127,808,088	111,058,898	(16,749,190)	0	0
Other governmental units		39,917,708	39,917,708	0	0
Total revenues	1,740,491,944	1,768,029,338	27,537,394	0	0
Expenditures:					
General administrative and support					
Air transportation	57,918,117	59,296,467	(1,378,350)	0	0
Revenue sharing	13,857,380	3,945,167	9,912,213	0	0
Rail transportation	205,132,078	211,594,506	(6,462,428)	0	0
Public transportation	988,300	33,686	954,614	0	0
Highways	17,343,500	58,205,174	(40,861,674)	0	0
Vehicle regulation	1,159,371,595	1,182,186,903	(22,815,308)	0	0
Governors Office for Technology	34,735,340	34,760,843	(25,503)	0	0
Economic development bond projects	125,000	90,868	34,132	0	0
Justice Cabinet	30,000,000	63,361,123	(63,361,123)	0	0
Revenue Cabinet	1,385,000	30,000,000	0	0	0
Finance and Administration Cabinet	277,000	1,385,000	0	0	0
Capital projects		276,840	160	0	0
Total expenditures	1,521,133,310	1,645,136,577	(124,003,267)	10,370,000	13,334,283
				10,370,000	13,334,283
					(2,964,283)
					(2,964,283)

Excess (deficiency) of revenues over expenditures	219,358,634	122,892,761	(96,465,873)	(10,370,000)	(13,334,283)	(2,964,283)
Other sources (uses) of financial resources:						
Operating transfers in (out):						
General Fund	6,137,185	6,137,185	0			0
Debt service / lease payments	(152,327,700)	(150,649,800)	1,677,900			0
Capital projects	(10,370,000)	(10,370,000)	0	10,370,000	22,370,000	12,000,000
Finance and Administration Cabinet	(3,665,000)	(3,665,000)	0			
Net other transfers	1,454,783	1,454,783	0		(900,000)	(900,000)
Net other sources (uses) of financial resources	(158,770,732)	(157,092,832)	1,677,900	10,370,000	21,470,000	11,100,000
Excess (deficiency) of revenues over expenditures and net other sources (uses) of financial resources	\$ 60,587,902	(34,200,071)	\$ (94,787,973)	\$ 0	8,135,717	\$ 8,135,717
Fund balance, July 1, 2000		734,811,619			19,211,785	
Fund balance, June 30, 2001	\$	700,611,548	\$		27,347,502	

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
INTERNAL SERVICE FUNDS
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2001

Cash flows from operating activities:	
Cash received from Special Revenue Fund	\$ 3,611,366
Cash received from operating revenues - charges for services	23,236,139
Cash payments for claims expense	(3,321,445)
Cash payments for legal expense	(220,077)
Cash payments for operations	(14,447,212)
Cash payments for administrative expense	<u>(69,844)</u>
Net cash provided by operating activities	<u>8,788,927</u>
Cash flows from investing activities:	
Sales of investments, net	<u>860,264</u>
Cash flows from capital and related financing activities:	
Purchases of fixed assets	(7,933,346)
Cash payments for leases of fixed assets	(2,411,268)
Cash received from sales of equipment	1,467,458
Cash payments for interest expense	<u>(307,520)</u>
Net cash used in capital and related financing activities	<u>(9,184,676)</u>
Increase in cash and cash equivalents	464,515
Cash and cash equivalents, July 1, 2000	<u>15,266</u>
Cash and cash equivalents, June 30, 2001	<u>\$ 479,781</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (3,510,865)
Depreciation	12,016,743
Decrease in intergovernmental receivable	491,060
Increase in claims liability	358,682
Decrease in accounts payable	<u>(566,693)</u>
Net cash provided by operating activities	<u>\$ 8,788,927</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity:

Kentucky Revised Statute Chapter 174 provides that the Transportation Cabinet (the Cabinet) has the responsibility for all the Commonwealth of Kentucky (State) owned transportation facilities and programs, including planning, financing, construction, operation and maintenance of various modes of transportation and carrying out related licensing and administrative functions. The Cabinet enters into various agreements with the Federal Highway Administration and the Turnpike Authority of Kentucky (the Authority), which is a related party, and provides part of the funding for highway construction projects.

The Cabinet is headed by the Secretary, whose staff is responsible for the following offices and departments: Office of General Counsel and Legislative Affairs, Office of Minority Affairs, Office of Policy and Budget, Office of Public Affairs, Office of Quality, Office of Technology, Office of Transportation Delivery, Department of Administrative Services, Department of Fiscal Management, Department of Highways, Department of Human Resources Management, Department of Rural and Municipal Aid and Department of Vehicle Regulation. Within the Department of Highways there are five offices which are the responsibility of the State Highway Engineer, these are: Office of Project Development, Office of Construction and Operations, Office of Program Planning and Management, Office of Intermodal Planning, and the Highway District Offices.

The Special Revenue, Capital Projects, Internal Service and Agency Funds administered by the Cabinet consolidate all fiscal resources dedicated to transportation, including license and privilege taxes, federal grants, the Authority's construction reimbursements, toll facility fares and General Fund appropriations. A significant portion of gasoline, special fuels and all usage taxes are collected by the Revenue Cabinet on behalf of the Cabinet.

Leases on Toll, Economic Development and Resource Recovery Roads are serviced by the Cabinet. While the Cabinet services these leases, the Cabinet is not ultimately responsible for the retirement of the debt. Accordingly, the debt has not been accounted for in the General Long-term Debt Account Group of the Cabinet.

The Cabinet's financial statements are included in the State's Comprehensive Annual Financial Report (CAFR).

Basis of Presentation:

The financial activities are recorded in the individual funds, classified by type and account groups described below:

- I. Special Revenue Fund: Transactions related to resources obtained, the uses of which are legally restricted to specific purposes, are accounted for in the Special Revenue Fund. The Special Revenue Fund includes resources used for operations and the Cabinet's share of leases on Toll, Economic Development and Resource Recovery Roads.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (continued):

- II. Capital Project Funds: Transactions relating to the acquisition, construction, or renovation of the Cabinet's major capital facilities and for the acquisition of major equipment are accounted for in the Capital Projects Fund. Under Kentucky Revised Statutes, transactions for capital facilities and items of major equipment relating to the construction or maintenance of roads are not accounted for in the Capital Projects Fund and, accordingly, are recorded in the Special Revenue Fund.
- III. Internal Service Funds: Internal Service Funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the government or to other governmental units, on a cost reimbursement basis.

They are composed of:

- 1. Workers' Compensation Fund: This fund is used to provide worker's compensation insurance to the employees of the Cabinet. Claims incurred by the Workers' Compensation Fund are serviced by a designated third-party administrator who processes and reports all claims to the Workers' Compensation Fund. Contributions are made from the Special Revenue Fund of the Cabinet based upon amounts budgeted for the Cabinet's fiscal year.
 - 2. Fleet Management Fund: This fund is used to account for the rental of motor vehicles to other departments and related costs.
- IV. Agency Fund: Transactions related to assets held by the Cabinet for other governmental units, agencies or individuals are included in the Agency Fund.
- V. General Fixed Assets Account Group: General fixed assets acquired for use by the Cabinet in the conduct of its activities are reflected in the General Fixed Assets Account Group.
- VI. General Long-Term Debt Account Group: Accrued compensated absences, claims and judgments, and other obligations are reflected in the General Long-Term Debt Account Group.

The accounts of the Special Revenue, Capital Projects and Agency Funds are maintained and reported using the modified accrual basis of accounting. The accounts of the Internal Service Funds are reported on the accrual basis of accounting. Contributions to the Internal Service Funds are made from the Special Revenue Fund of the Cabinet based upon amounts budgeted for the Cabinet's fiscal year.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (continued):

The financial statements of the Internal Service Funds have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. With respect to proprietary activities, the Internal Service Funds have adopted GASB Statement No. 20, *"Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting."* The Internal Service Funds have elected to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) Opinions issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements.

Under the modified accrual basis of accounting, revenues are susceptible to accrual and recognized in the combined financial statements when they are measurable and available to finance operations during the year or liquidate liabilities existing at the end of the year. The Cabinet defines "available" as revenues to be collected within 30 days except for intergovernmental revenues which are available if expected receipt is within one year. Material revenues susceptible to accrual include federal grants, motor vehicle fuel and excise taxes, and the Authority's construction reimbursements. Expenditures and liabilities are recognized when obligations are incurred except for compensated absences, claims and judgments, and other obligations which are accounted for in the General Long-Term Debt Account Group and recorded as expenditures of the Special Revenue Fund when paid.

Cash and Cash Equivalents:

Cash and cash equivalents consist of cash on hand, imprest cash, cash in banks, and short-term investments included in the State's general depository. The short-term investments include investments with a maturity of 90 days or less from date of purchase, and are stated at cost, which approximates market. Short-term investments, classified as cash equivalents, were approximately \$88,780,000 at June 30, 2001.

Investments:

Investments are reported at fair value as determined by quoted market prices. All investment income on investments owned by the Capital Projects Fund and the Internal Service Fund - Fleet Management Fund, for the year ended June 30, 2001, in the amounts of \$23,332,607 and \$2,539,000 respectively, is recorded in the State's Capital Projects Fund and the Internal Service Fund, respectively.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Inventory:

Expenditures for expendable supplies are recorded when purchased. Nonexpendable supplies held as inventory at fiscal year-end are recorded at cost (first-in, first-out or average cost method) and are equally offset by a fund balance reserve which indicates that they are not available for appropriation and expenditure at the balance sheet date.

Restricted Assets:

These assets represent compensating balance agreements with toll road depositories and other governmental agencies' construction cooperative trust accounts in the amounts of \$1,900,000 and \$217,114, respectively. The restricted assets consist of cash and investments in the amounts of \$1,900,000 and \$217,114, respectively.

Fixed Assets:

General fixed assets are not capitalized in the funds to acquire or construct them. Instead, capital acquisitions and construction are reflected as expenditures in the Special Revenue Fund and the Capital Projects Fund, and the related assets are reported in the General Fixed Assets Account Group. All purchased fixed assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist.

Public domain (infrastructure) general fixed assets consisting of highways, roads, bridges, curbs and gutters are not capitalized, as these assets are immovable and of value only to the government.

Assets in the General Fixed Assets Account Group are not depreciated.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not included in the General Fixed Assets Account Group or capitalized in the proprietary funds.

Automotive equipment in the proprietary funds is recorded at cost and is depreciated using the straight-line method over the useful life, which is five years.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences:

Compensated absences reported in the general long-term debt account group include accumulated unpaid vacation and compensatory time accruals. No expenditure is reported for these amounts. Accumulated vacation that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability of the governmental fund that will pay it. Accumulated compensated absences of proprietary funds are recorded as an expense and liability of those funds as the benefits accrue to employees.

The policy of the Commonwealth is to record the cost of annual and compensatory leave. Annual leave is accumulated at amounts ranging from 7.5 to 15.00 hours per month, determined by length of service, with maximum accumulations ranging from 30 to 60 days. The calendar year is the period used for determining accumulated leave. At June 30, 2001, the estimated liability for accrued annual leave for the Cabinet is \$28,523,321. Compensatory leave is granted to authorized employees on an hour-for-hour basis. At June 30, 2001, the estimated liability for compensatory leave for the Cabinet is \$8,576,924.

Sick Leave:

Sick leave for the Cabinet is earned one day per month with unlimited accumulations. All of the qualifying retiring employees' sick leave balances, expressed in months, shall be added to their service credit for the purpose of determining their annual retirement.

There is no liability in the accompanying financial statements for unpaid accumulated sick leave, since it is the Cabinet's policy to record the cost of sick leave only when paid. See Note 7 for the disclosure of the amount of this contingency.

Outstanding Capital Lease Obligations:

Capital lease obligations for government funds and expendable trust funds are reported in the general-long term debt account group.

Judgments and Contingent Liabilities

Judgments and contingent liabilities of the Cabinet which will not be paid with current resources are reported in the general long-term debt account group.

Encumbrances:

The state-funded portion of encumbrances, represented by executed and unperformed contracts and appraised rights of way, is recorded as reservations of fund balance at the end of the fiscal year.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Encumbrances (Continued):

The Cabinet has entered into certain agreements with third parties, notably the Federal Highway Administration and the Authority, for construction projects. These third parties have agreed to participate in the cost of the construction projects. The percentage of participation varies from one agreement to another. The third parties' portion of encumbrances, which was approximately \$577,186,000 at June 30, 2001, has been deducted from the related encumbrances in the accompanying combined balance sheet. Revenues and expenditures, in respect to these agreements, are recognized when contracted work or state force account work is earned or when rights of way are purchased.

Deferred Revenue:

Deferred revenue consists primarily of proceeds from Economic Development bonds issued on behalf of the Cabinet. Revenues are recognized in the Special Revenue Fund as the proceeds are utilized.

Unpaid Claims Liabilities of the Internal Service Funds:

The Internal Service Funds establish claims liabilities based on estimated allowances for (i) claims settlements for reported, outstanding claims, (ii) claims settlements for incurred but unreported claims (based on historical experience), and (iii) legal and administrative expenses necessary to make such settlements. The liability is not discounted for the time value of money. To the extent that actual claims and legal and administrative expense payments differ from recorded allowances, operations will be charged or credited.

Federal Government Revenue:

Federal Government revenue consists principally of reimbursable grants from the Federal Highway Administration in connection with highway construction projects, the Federal Transit Administration, the Federal Rail Administration and the Federal Aeronautics Administration. In addition, the Cabinet is a subrecipient of funds from federal grants relating to energy conservation, highway safety, and Federal Emergency Management Agency Funds.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Appropriations to Other State Cabinets:

The 2000 General Assembly appropriated \$35,452,000 of the Special Revenue Fund dollars to the State's Finance and Administration, Revenue and Justice Cabinets for the enforcement of state traffic and motor vehicle laws, collection of road taxes, payment of lease rentals, furnishing mail services and information technology services for the year ended June 30, 2001. The four items are shown as expenditures and transfers on the combined statement of revenues, expenditures and changes in fund balance.

Total Column on Balance Sheet:

The total column on the combined balance sheet is captioned Memorandum Only to indicate that it is presented only to facilitate financial analysis. Data in this column does not present financial position in conformity with generally accepted accounting principles. Neither is such data comparable to a consolidation.

NOTE 2 - BUDGETING AND BUDGETARY CONTROL

For purposes of budgeting, the State's budgetary structure and accounting principles differ from those utilized to present financial statements in conformity with GAAP.

The budget for the biennium is prepared with two-year projections being made in light of the long-range program requirements and revenue estimates. The biennial budget request is prepared by the Cabinet and presented to the Governor for submission to the Kentucky General Assembly at its biennial session.

The Kentucky General Assembly is required to enact a balanced budget. Budgetary control is exercised by the Finance and Administration Cabinet on the basis of appropriations to the various cabinets. For purposes of managing budgeted appropriations, the Cabinet controls expenditures on a functional basis. Unexpended appropriations, except for those dedicated by statute, from the General Fund of the State lapse to the General Fund. Unexpended appropriations of the Special Revenue Fund may be carried over the extent of (a) project obligations and (b) encumbrances which are approved by the Governor's Office of Policy and Management.

The Cabinet's budgeting is dependent upon undesignated fund balance and estimated revenues in determining (a) available funds for statutory programs, (b) lease rental obligations, (c) construction program requirements, and (d) operating requirements. The budget is developed from the analysis of the above factors, prior-year performance, and new data modifying or expanding the highway program for the fiscal period in question.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 3 - BUDGETARY BASIS VERSUS GAAP

The accompanying Combined Statement of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual (Budgetary Basis) presents comparisons of the legally adopted budget with actual data on the budgetary basis. Since accounting principles applied for purposes of developing data on the budgetary funds differ significantly from those used to present financial statements in conformity with GAAP, a schedule reconciling the fund balance on the budgetary basis at June 30, 2001 to the fund balance on a modified accrual basis follows:

	Special Revenue <u>Fund</u>	Capital Projects <u>Fund</u>
Fund balance, June 30, 2001 (Budgetary Basis)	\$ 700,611,548	\$ 27,347,502
Adjustments:		
Accrued revenues	165,476,607	75,461
Accrued expenditures	(88,356,901)	(28,886)
Accrued transfers, net	<u>273,285</u>	
Total adjustments	<u>77,392,991</u>	<u>46,575</u>
Fund reclassifications:		
Reserve for inventory of supplies	26,425,282	0
Reserve for restricted assets	2,117,114	0
Revenue bond proceeds included in deferred revenue	<u>(136,725,783)</u>	<u>0</u>
Total fund reclassifications	<u>(108,183,387)</u>	<u>0</u>
Fund balance, June 30, 2001 (GAAP Basis)	<u><u>\$ 669,821,152</u></u>	<u><u>\$ 27,394,077</u></u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 4 - DEPOSITS AND INVESTMENTS

All agency receipts are deposited directly in the State's general depository or depositories designated by the State Treasurer, which has statutory responsibility and authority to safeguard the funds. At June 30, 2001, the Cabinet's share of deposits in the State's general depository was \$763,561,136. Accordingly, the State's Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2001 should be referred to for disclosures required by GASB Statement No. 3, "*Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements.*"

A summary of cash deposits not held by the State as of June 30, 2001 follows:

	<u>Carrying Value</u>	<u>Bank Balance</u>
Insured FDIC	\$ 500,000	\$ 500,000
Uninsured:		
Collateral held by pledging bank's trust department in Cabinet's name	1,561,772	1,608,904
Uncollateralized:		
Held at banks	66,529	83,198
	<u>\$ 2,128,301</u>	<u>\$ 2,192,102</u>

All unrestricted investments are managed by the State in their investment pool. Restricted investments are managed by a financial institution's trust department. Investments are categorized as either (1) insured or registered or for which the securities are held by the State or its agent in the State's name, (2) uninsured and unregistered for which the securities are held by the broker's or dealer's trust department or agent in the State's name or (3) uninsured and unregistered for which the securities are held by the broker or dealer, or by its trust department or agent, but not in the State's name.

	<u>1</u>	<u>2</u>	<u>3</u>	<u>Fair Value</u>
SNB Variable Rate Investment Account	\$ 217,114	-	-	\$ 217,114
Total investments	<u>\$ 217,114</u>	<u>-</u>	<u>-</u>	<u>\$ 217,114</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 4 - DEPOSITS AND INVESTMENTS (CONTINUED)

A reconciliation of cash and investments as shown on the combined balance sheet follows:

Cabinet's share of deposits and investments held by the State	\$ 763,561,136
Carrying amount of deposits not held by the State	2,128,301
Carrying amount of investments not held by the State	217,114
	<u>\$ 765,906,551</u>
 Cash and cash equivalents	 \$ 93,302,739
Investments at fair value	670,486,698
Restricted assets	2,117,114
	<u>\$ 765,906,551</u>

NOTE 5 - FIXED ASSETS

Activity in the General Fixed Assets Account Group for the Cabinet for the year ended June 30, 2001 was as follows:

	Balance <u>July 1, 2000</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>June 30, 2001</u>
Land	\$ 5,940,085	\$	\$	\$ 5,940,085
Buildings	68,016,390	1,734,622	(93,160)	69,657,852
Equipment:				
Office	4,792,416	542,283	(194,451)	5,140,248
Construction and maintenance	100,920,563	4,276,904	(1,874,397)	103,323,070
Data Processing	11,185,997	447,088	(899,702)	10,733,383
Construction in progress	15,265,012	6,668,183	(3,253,810)	18,679,385
	<u>\$ 206,120,463</u>	<u>\$ 13,669,080</u>	<u>\$ (6,315,520)</u>	<u>\$ 213,474,023</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 5 - FIXED ASSETS (CONTINUED)

The following is a summary of the Internal Service Fund – Fleet Management Fund fixed assets at June 30, 2001:

Automobiles	\$ 83,314,468
Less accumulated depreciation	<u>(53,134,730)</u>
Total	<u>\$ 30,179,738</u>

NOTE 6 - CHANGES IN GENERAL LONG-TERM DEBT

Changes in General Long-Term Debt Account Group for the year ended June 30, 2001 are summarized as follows:

	Compensated <u>Absences</u>	Judgments <u>and Litigation</u>
Balance, July 1, 2000	\$ 33,959,952	\$ 15,488,000
Net increase	<u>3,140,293</u>	<u>8,942,000</u>
Balance, June 30, 2001	<u>\$ 37,100,245</u>	<u>\$ 24,430,000</u>

Revenue Bonds of the Authority are accounted for in the General Long-Term Debt Account Group in the State's CAFR (see Note 15). See Note 13 for additional discussion regarding judgments and litigation.

NOTE 7 - COMMITMENTS

Road Leases:

The Cabinet operates certain toll roads within the State under lease rental agreements with the Authority.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 7 - COMMITMENTS (CONTINUED)

Road Leases (Continued):

The lease-rental agreements cover a two-year period with automatic renewal options for each succeeding two-year period until all bonds have been retired. There is no indication that the leases will not continue to be renewed.

The agreements provide, among other things, annual rental payments to be made from the Special Revenue Fund in amounts equal to the debt service requirements of the Authority's revenue bonds issued to finance the construction of the toll roads during the period in which the revenue bonds are outstanding, and to collect and retain the tolls collected from users of the toll roads.

The Cabinet entered into additional lease-rental agreements and a supplement thereto with the Authority for the construction of various coal-haul roads under the Resource Recovery Road System and construction of economic development road projects under the Economic Development Road System. The terms of these agreements are similar to those covering the aforementioned toll roads except that these agreements make no provision for collection of tolls.

Lease-rental payments for the year ended June 30, 2001 were \$150,649,800, reported as operating transfers out, for debt service payments. The rental commitments for leases in effect at June 30, 2001 assuming the exercise of the lease renewal options were:

<u>Fiscal Year</u>	<u>Toll Roads</u>	<u>Resource Recovery Roads</u>	<u>Economic Development</u>	<u>Total</u>
2002	\$ 2,800,600	\$ 16,508,182	\$ 163,323,864	\$ 182,632,646
2003	2,800,600	30,492,670	147,346,339	180,639,609
2004	2,800,600	43,047,243	128,264,875	174,112,718
2005	21,741,550	43,049,334	72,222,696	137,013,580
2006	12,537,000	43,046,350	81,395,434	136,978,784
Thereafter	<u>22,273,725</u>	<u>66,652,300</u>	<u>674,658,148</u>	<u>763,584,173</u>
	<u>\$ 64,954,075</u>	<u>\$ 242,796,079</u>	<u>\$ 1,267,211,356</u>	<u>\$ 1,574,961,510</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 7 - COMMITMENTS (CONTINUED)

It is anticipated that the above rental commitments will be reduced by interest earned (using actual interest rates on long-term investment obligations maintained in the respective funds) on the investments of Debt Service Reserve Funds maintained by the Authority and net rental commitments will be as follows:

<u>Fiscal Year</u>	<u>Toll Roads</u>	<u>Resource Recovery Roads</u>	<u>Economic Development</u>	<u>Total</u>
2002	\$ 548,600	\$ 12,220,426	\$ 160,190,306	\$ 172,959,332
2003	548,600	26,204,914	144,212,781	170,966,295
2004	548,600	38,759,487	125,305,243	164,613,330
2005	19,489,550	38,761,578	69,263,064	127,514,192
2006	9,069,000	38,758,594	78,435,800	126,263,394
Thereafter	<u>0</u>	<u>7,164,032</u>	<u>607,848,319</u>	<u>615,012,351</u>
	<u>\$ 30,204,350</u>	<u>\$ 161,869,031</u>	<u>\$ 1,185,255,513</u>	<u>\$ 1,377,328,894</u>

Capital Leases:

The Cabinet has entered into lease agreements for the purchase of certain vehicles and equipment maintained by the Fleet Management Fund and the General Fixed Assets Account Group. The future minimum lease obligations and net present value of these minimum lease payments as of June 30, 2001 are \$16,790,220 exclusive of interest of approximately \$2,695,000. Future minimum lease payments required under this capital lease are as follows:

<u>Fiscal Year</u>	<u>Internal Service</u>	<u>General Long Term Debt</u>	<u>Total</u>
2002	\$ 1,354,903	\$ 3,796,781	\$ 5,151,684
2003	1,354,903	3,820,891	5,175,794
2004	1,354,903	3,820,531	5,175,434
2005	133,014	2,057,423	2,190,437
2006	<u>0</u>	<u>1,791,796</u>	<u>1,791,796</u>
Total	<u>4,197,723</u>	<u>15,287,422</u>	<u>19,485,145</u>
Less amount representing interest	<u>(325,723)</u>	<u>(2,369,202)</u>	<u>(2,694,925)</u>
Present value of minimum lease payments	3,872,000	12,918,220	16,790,220
Less current portion	<u>(1,186,768)</u>	<u>(3,022,355)</u>	<u>(4,209,123)</u>
Long-term portion	<u>\$ 2,685,232</u>	<u>\$ 9,895,865</u>	<u>\$ 12,581,097</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 7 - COMMITMENTS (CONTINUED)

Capital Leases (Continued):

Amortization of assets held under capital leases is included with depreciation expense.

Deferred Contracts:

The Cabinet follows a policy of executing contracts in the current year which are to be financed by appropriations of the next fiscal year. Such contracts totaled \$99,315,000 at June 30, 2001 and have not been recognized as a liability or as an encumbrance in the accompanying financial statements.

Sick Leave:

It is the policy of the Cabinet to record the cost of sick leave when paid. Generally, sick leave (earned one day per month with unlimited accumulation) is paid only when an employee is absent due to illness, injury, or related family death. There was no liability for sick leave at June 30, 2001. The estimated accumulated amount of unused sick leave at that date was \$57,325,000.

NOTE 8 - RISK MANAGEMENT

The Cabinet is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the Cabinet not to purchase commercial insurance for the risks of losses to which it is exposed. The Cabinet manages these risks as follows:

Torts; Theft of, Damage to, and Destruction of Assets; and Errors and Omissions:

The Cabinet manages its risks of loss related to torts; theft of, damage to, and destruction of assets; and errors and omissions internally by covering all claim settlements out of its Special Revenue Fund resources. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. At June 30, 2001, management has determined that no liability for such losses should be recorded other than the liability reflected in the Special Revenue Fund and the General Long-Term Debt Account Group related to the contingencies discussed in Note 11.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 8 - RISK MANAGEMENT (CONTINUED)

Injuries to Employees:

As discussed in Note 1, the Worker's Compensation Fund establishes claims liabilities for both reported and unreported insured events, which includes estimates of both future payments of losses and related claims adjustment expenses. The following represent changes in those aggregate liabilities for the fund for the years ended June 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Balance at beginning of fiscal year	\$ 19,491,107	\$ 17,877,633
Claims and claims adjustments incurred	3,680,127	4,908,957
Claims and claims adjustment payments	<u>(3,321,445)</u>	<u>(3,295,483)</u>
Balance at end of fiscal year	\$ <u>19,849,789</u>	\$ <u>19,491,107</u>

The Cabinet is also a member of the Statewide Worker's Compensation Insurance Program Special Fund, a risk sharing pool which covers pre-existing conditions to protect employers from having to pay for injuries not sustained in their employ, or more than once for disabilities resulting from the same accident. This program encourages re-employment of injured workers at adequate wages by relieving the employer of the requirement of paying disability compensation in addition to full wages. This program also covers claims against uninsured employers. The amount paid to this program during the year ended June 30, 2001 was approximately \$289,000. See the State's CAFR for the year ended June 30, 2001 for additional disclosures.

Natural Disasters:

The Cabinet utilizes the Commonwealth of Kentucky's Risk Management Fund to cover the exposure to loss arising from damages to the Cabinet's buildings and personal property. Note 11 of the Commonwealth of Kentucky's Comprehensive Annual Financial Reports should be referred to for additional disclosures related to the Risk Management Fund.

NOTE 9 - RETIREMENT AND PENSION SYSTEM

All eligible full-time employees of the Cabinet participate in the Kentucky Retirement System (the System), a multiple-employer public employee retirement system. The System provides for retirement, disability, death and health insurance benefits. Participants have a fully vested interest after the completion of 60 months of service, 12 of which are current service. At a minimum, terminated employees are refunded their contributions with credited interest. Benefits and contribution rates are established by State statute. Historical trend information for the System is presented in the System's Annual Financial Report for the year ended June 30, 2001,

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 9 - RETIREMENT AND PENSION SYSTEM (CONTINUED)

which is public record. Additionally, other required disclosures are included in the State's CAFR for the year ended June 30, 2001.

The payroll for employees of the Cabinet covered by the System for the year ended June 30, 2001 was approximately \$220,257,000; the Cabinet's total payroll was approximately \$221,601,000.

Covered employees are required by State statute to contribute 5% of their creditable compensation to the System. The Cabinet is required by the same statute to contribute the remaining amounts necessary to pay benefits when due. The current rate is 5.89% of annual covered payroll. The contribution requirement for the year ended June 30, 2001 was \$26,019,000, which consisted of \$13,681,000 from the Cabinet and \$12,338,000 from employees.

NOTE 10 - AGENCY FUND

Changes in assets and liabilities of the Agency Fund follow:

	<u>Balance</u> <u>July 1, 2000</u>		<u>Additions</u>		<u>Disposals</u>		<u>Balance</u> <u>June 30, 2001</u>
Assets:							
Cash and cash equivalents	\$ 13,579,258	\$		\$	(8,482,847)	\$	5,096,411
Investments, at fair value	17,957,839		8,711,161				26,669,000
	<u> </u>		<u> </u>		<u> </u>		<u> </u>
Total assets	\$ <u>31,537,097</u>	\$	<u>8,711,161</u>	\$	<u>(8,482,847)</u>	\$	<u>31,765,411</u>
Liabilities:							
Accounts payable to political subdivisions	\$ <u>31,537,097</u>	\$	<u>13,807,572</u>	\$	<u>(13,579,258)</u>	\$	<u>31,765,411</u>
Total liabilities	\$ <u>31,537,097</u>	\$	<u>13,807,572</u>	\$	<u>(13,579,258)</u>	\$	<u>31,765,411</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 11 - CONTINGENCIES

As of June 30, 2001, the Cabinet has been named as a defendant in various legal actions seeking recovery of approximately \$33,500,000 in the aggregate. In the opinion of the Office of General Counsel of the Cabinet, the amount of probable liability (not considering any portions previously encumbered or reimbursable by another agency) with respect to these actions, determined in accordance with FASB No. 5, is approximately \$9,430,000.

The accompanying combined balance sheet also includes an estimated liability of \$24,000,000 related to a verdict reached against the Commonwealth of Kentucky during 2001, which in the opinion of the Office of General Counsel of the Cabinet, required accrual in accordance with FASB No. 5. Of this total, \$9,000,000 is expected to be liquidated with available expendable financial resources of the Special Revenue Fund and, accordingly, has been accrued in the Special Revenue Fund as of June 30, 2001 and included in expenditures for highways in the accompanying combined statement of revenues, expenditures and changes in fund balance. Due to the length of time anticipated before the ultimate settlement of the remaining estimated liability of \$15,000,000 is reached, the Cabinet has concluded that this portion of the estimated liability should be reflected in the General Long-Term Debt Account Group. Of this amount, \$12,000,000 was accrued as of June 30, 2000 and an additional \$3,000,000 was accrued during the year ended June 30, 2001.

Federal grants are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits by the grantors. Any disallowances as a result of these audits become a liability of the Cabinet. During May of 2001 the Federal Highway Administration of the U. S. Department of Transportation conducted a program review of the Cabinet's Disadvantaged Business Enterprise Program (Program), which indicated that the Cabinet's administration of the Program deviated from its processes and procedures as approved by the Federal Highway Administration. The report, dated in July of 2001, outlined items that should be addressed by the Cabinet for orderly management of the Program and indicated that the Federal Highway Administration will continue to monitor the administration of the Program and reevaluate its status in six months. The Cabinet has developed and is in the process of implementing an action plan in response to the program review report and management does not believe there will be any material adjustments to the Cabinet's federal grants. Accordingly, no provision for any liability has been made in the accompanying financial statements.

NOTE 12 - RELATED PARTY TRANSACTIONS

The Cabinet recognized construction expenditures of approximately \$61,699,000 during the year ended June 30, 2001, which were paid directly from the Economic Development Road (Revitalization Projects) Revenue Bonds proceeds.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2001

NOTE 12 - RELATED PARTY TRANSACTIONS (CONTINUED)

The Cabinet operates the motor pool for the benefit of other agencies within the State. The motor pool is accounted for as the Fleet Management Fund, an Internal Service Fund. Departmental fees, sales and rentals include revenues of approximately \$22,745,000 for the year ended June 30, 2001, collected in connection with the operation of the motor pool.

The Governor's Office for Technology is responsible for providing services for State Government operations. The Cabinet has paid approximately \$10,740,000 to the Governor's Office for Technology for services provided during the year ended June 30, 2001.

The Cabinet paid the Finance and Administration Cabinet approximately \$2,782,000 during the year ended June 30, 2001 for use of the State Office Building. Also, the Finance and Administration Cabinet's Office of Financial Management is authorized under Kentucky Revised Statute Chapter 42.410 to coordinate and manage the Cabinet's investment and idle the cash for the benefit of the Cabinet. The Cabinet has recognized approximately \$55,501,000 in interest payments from these investments during the fiscal year ended June 30, 2001. Additionally, the Cabinet received approximately \$8,588,000 in interest payments from the investment of the Economic Development Road (Revitalization Projects) Revenue Bonds proceeds during the year ended June 30, 2001.

NOTE 13 - DEFICIT OF THE INTERNAL SERVICE FUND

The Worker's Compensation Fund, an Internal Service Fund, has estimated liabilities which exceed its assets by \$19,849,789 as of June 30, 2001. This deficit primarily results from the utilization of a funding method designed to cover ensuing obligations of the fund. The Cabinet has indicated its intent to fund the deficiency and, to the extent that it does not, it would remain liable for all unpaid losses and other Internal Service Fund liabilities.

NOTE 14 - IMPACT OF NEW ACCOUNTING STANDARDS

In June 1999, the Governmental Accounting Standards Board issued GASB Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.*" The Commonwealth of Kentucky and its component units are required to apply this statement for periods beginning after June 15, 2001. GASB Statement No. 34 establishes new financial reporting requirements that fundamentally affect the presentation of the general-purpose government's basic financial statements and required supplementary information. Management has not yet assessed the impact that the adoption of GASB Statement No. 34 will have on the Cabinet's financial statements.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
INTERNAL SERVICE FUNDS
SUPPLEMENTAL SCHEDULE - COMBINING BALANCE SHEET
June 30, 2001

	Fleet Management <u>Fund</u>	Workers' Compensation <u>Fund</u>	Total (Memorandum <u>Only</u>)
<u>A S S E T S</u>			
Current assets:			
Cash on hand and on deposit with state treasurer	\$ 479,781	\$	\$ 479,781
Investments	2,539,000		2,539,000
Intergovernmental receivables	3,133		3,133
Total current assets	<u>3,021,914</u>	<u>0</u>	<u>3,021,914</u>
Fixed assets:			
Fixed assets	83,314,468		83,314,468
Less accumulated depreciation	<u>(53,134,730)</u>		<u>(53,134,730)</u>
Total fixed assets, net	<u>30,179,738</u>	<u>0</u>	<u>30,179,738</u>
Total assets	<u>\$ 33,201,652</u>	<u>\$ 0</u>	<u>\$ 33,201,652</u>
<u>L I A B I L I T I E S A N D E Q U I T Y</u>			
Current liabilities:			
Accounts payable	\$ 103,578	\$	\$ 103,578
Claims liability, current		2,905,469	2,905,469
Leases payable, current	1,186,768		1,186,768
Total current liabilities	<u>1,290,346</u>	<u>2,905,469</u>	<u>4,195,815</u>
Noncurrent liabilities:			
Claims liability, long-term		16,944,320	16,944,320
Leases payable, long-term	2,685,232		2,685,232
Total noncurrent liabilities	<u>2,685,232</u>	<u>16,944,320</u>	<u>19,629,552</u>
Total liabilities	<u>3,975,578</u>	<u>19,849,789</u>	<u>23,825,367</u>
Retained earnings:			
Unreserved	29,226,074		29,226,074
Accumulated deficit		<u>(19,849,789)</u>	<u>(19,849,789)</u>
Total equity (accumulated deficit)	<u>29,226,074</u>	<u>(19,849,789)</u>	<u>9,376,285</u>
Total liabilities and equity	<u>\$ 33,201,652</u>	<u>\$ 0</u>	<u>\$ 33,201,652</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
INTERNAL SERVICE FUNDS
SUPPLEMENTAL SCHEDULE - COMBINING STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN RETAINED EARNINGS (ACCUMULATED DEFICIT)
For the Year Ended June 30, 2001

	Fleet Management <u>Fund</u>	Workers' Compensation <u>Fund</u>	Total (Memorandum <u>Only</u>)
Operating revenues:			
Contributions received	\$	\$ 3,611,366	\$ 3,611,366
Charges for sales and services	<u>22,745,079</u>	<u> </u>	<u>22,745,079</u>
Total operating revenues	<u>22,745,079</u>	<u>3,611,366</u>	<u>26,356,445</u>
Operating expenses:			
Workers' compensation claims expense		3,680,127	3,680,127
Legal expense		220,077	220,077
Administrative expense		69,844	69,844
Costs of sales and services	13,880,519		13,880,519
Depreciation	<u>12,016,743</u>	<u> </u>	<u>12,016,743</u>
Total operating expenses	<u>25,897,262</u>	<u>3,970,048</u>	<u>29,867,310</u>
Operating loss	(3,152,183)	(358,682)	(3,510,865)
Other income (expense):			
Interest expense, net	(307,520)		(307,520)
Interest and other investment income	4,350		4,350
Gain on sale of equipment	<u>121,772</u>	<u> </u>	<u>121,772</u>
Total other income (expense)	<u>(181,398)</u>	<u> </u>	<u>(181,398)</u>
Net loss	<u>\$ (3,333,581)</u>	<u>\$ (358,682)</u>	<u>\$ (3,692,263)</u>
Retained earnings, July 1, 2000	\$ 32,559,655	\$	\$ 32,559,655
Net loss allocable to retained earnings	<u>(3,333,581)</u>	<u> </u>	<u>(3,333,581)</u>
Retained earnings, June 30, 2001	<u>\$ 29,226,074</u>	<u>\$ 0</u>	<u>\$ 29,226,074</u>
Accumulated deficit, July 1, 2000	\$	\$ (19,491,107)	\$ (19,491,107)
Net loss allocable to accumulated deficit	<u> </u>	<u>(358,682)</u>	<u>(358,682)</u>
Accumulated deficit, June 30, 2001	<u>\$ 0</u>	<u>\$ (19,849,789)</u>	<u>\$ (19,849,789)</u>

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
INTERNAL SERVICE FUNDS
SUPPLEMENTAL SCHEDULE - COMBINING STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2001

	Fleet Management <u>Fund</u>	Workers' Compensation <u>Fund</u>	Total (Memorandum <u>Only</u>)
Cash flows from operating activities:			
Cash received from Special Revenue Fund	\$	\$ 3,611,366	\$ 3,611,366
Cash received from operating revenues - charges for services	23,236,139		23,236,139
Cash payments for claims expense		(3,321,445)	(3,321,445)
Cash payments for legal expense		(220,077)	(220,077)
Cash payments for operations	(14,447,212)		(14,447,212)
Cash payments for administrative expense		(69,844)	(69,844)
	<u>8,788,927</u>	<u>0</u>	<u>8,788,927</u>
Net cash provided by operating activities			
Cash flows from investing activities:			
Sale of investments, net	<u>860,264</u>		<u>860,264</u>
Cash flows from capital and related financing activities:			
Purchase of fixed assets	(7,933,346)		(7,933,346)
Cash payments for leases of fixed assets	(2,411,268)		(2,411,268)
Cash received from sale of equipment	1,467,458		1,467,458
Cash payments for interest expense	(307,520)		(307,520)
	<u>(9,184,676)</u>	<u>0</u>	<u>(9,184,676)</u>
Net cash used in capital and related financing activities			
Increase in cash and cash equivalents	464,515	0	464,515
Cash and cash equivalents, July 1, 2000	<u>15,266</u>		<u>15,266</u>
Cash and cash equivalents, June 30, 2001	<u>\$ 479,781</u>	<u>\$ 0</u>	<u>\$ 479,781</u>
Reconciliation of operating loss to net cash provided by operating activities:			
Operating loss	\$ (3,152,183)	\$ (358,682)	\$ (3,510,865)
Depreciation	12,016,743		12,016,743
Decrease in intergovernmental receivable	491,060		491,060
Increase in claims liability		358,682	358,682
Decrease in accounts payable	(566,693)		(566,693)
	<u>(566,693)</u>	<u>358,682</u>	<u>(566,693)</u>
Net cash provided by operating activities	<u>\$ 8,788,927</u>	<u>\$ 0</u>	<u>\$ 8,788,927</u>

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Mr. James C. Codell, III, Secretary
Transportation Cabinet
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Commonwealth of Kentucky

We have audited the financial statements of the Transportation Cabinet of the Commonwealth of Kentucky (the Cabinet) as of and for the year ended June 30, 2001, and have issued our report thereon dated November 26, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Cabinet's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Cabinet's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Cabinet in a separate letter dated November 26, 2001.

Mr. James C. Codell, III, Secretary
Transportation Cabinet
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Commonwealth of Kentucky

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This report is intended solely for the information and use of the Cabinet's management and the Auditor of Public Accounts of the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these specified parties.

Potter + Company, LLP

POTTER & COMPANY, LLP
November 26, 2001

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS
Year Ended June 30, 2001

Schedule of Auditor's Results

We have issued an unqualified opinion dated November 26, 2001, on the financial statements of the Transportation Cabinet of the Commonwealth of Kentucky as of and for the year ended June 30, 2001.

Our audit disclosed no instances of noncompliance which are material to the Transportation Cabinet's financial statements.

Findings Relating to the Financial Statements

Our audit disclosed no findings, which are required to be reported in accordance with *Government Auditing Standards*.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTION
Year Ended June 30, 2000

No findings required to be reported in accordance with *Government Auditing Standards* were reported for the year ended June 30, 2000.

